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# India–U.S. Economic Relations

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## Summary

India is a country with a long history and a large population (more than one billion people, nearly half living in poverty). Given that it is the world's most populous democracy, a U.S. ally in anti-terrorism efforts, and a potentially major export market, India's economic development and its trade relations with the United States are of concern to Congress. This report will be updated as events warrant.

## India's Economy

Upon achieving independence from British rule in 1947, India pursued policies that sought to assert government planning over most sectors of the economy and strove to promote relative economic self-sufficiency. These policies included extensive government spending on infrastructure, the promotion of government-owned companies, pervasive regulatory authority over private sector investment, and extensive use of trade and investment barriers to protect local firms from foreign competition. While these policies achieved some economic goals (such as rapid industrialization), the overall effect was to promote widespread inefficiency throughout the economy (e.g., unprofitable state-run firms and a constrained private sector) and to greatly restrict the level of foreign direct investment (FDI) in India. India's real GDP growth was relatively stagnant during the 1970s, averaging about 2.7%. Piecemeal economic reforms and increased government spending during the 1980s helped boost average real GDP growth to 6.0%.<sup>1</sup>

### 1991 Economic Crisis and Reforms

India suffered a major economic crisis in 1991, largely due to the effects of oil price shocks (resulting from the 1990 Gulf War), the collapse of the Soviet Union (a major trading partner and source of foreign aid), and a sharp depletion of its foreign exchange reserves (caused largely by large and continuing government budget deficits).<sup>2</sup> The economic crisis led the Indian government to cut the budget deficit and implement a number of economic reforms, including sharp cuts in tariff and non-tariff barriers, liberalization of foreign direct investment (FDI) rules, exchange rate and banking reforms, and a significant reduction in the government's control over private sector investment (by removing licensing requirements). These reforms helped boost economic growth and led to a surge in FDI flows to India in the mid-1990s (annual FDI rose from about \$100 million in 1990 to \$2.4 billion by 1996; more than one-third came from U.S. investors). Reform efforts stagnated, however, under the weak coalition governments of the mid-1990s. The 1997/1998 Asian financial crisis and U.S.-imposed sanctions on India (as a result of its May 1998 nuclear tests) further dampened the economic growth.<sup>3</sup> Following parliamentary elections in 1999, the government launched second-generation economic reforms, including major deregulation, privatization, and tariff-reducing measures.

### Current Economic Conditions

India's economic growth has been relatively robust over the past few years. Real GDP grew by 8.2% in 2003 and by an estimated 5.7% in 2004. *Global Insight*, an economic forecasting firm, projects India's real GDP will rise by 6.3% in (FY) 2005 and 6.0% in 2006.<sup>4</sup> By some measurements, India is among the world's largest economies. While on a nominal U.S. dollar exchange rate basis, India's 2003 GDP was \$577 billion. However, on a purchasing power parity (PPP) basis (which factors in differences in prices across countries), India's GDP is estimated at close to \$3 trillion. By this measurement, India is the world's fourth-largest economy (after the

<sup>1</sup> Unless otherwise noted, data on India are on a fiscal year basis that runs from April to March.

<sup>2</sup> The central government's budget deficit as a percent of GDP averaged over 7% from 1980 to 1990. The high level of government debt became unsustainable as the high right of government borrowing raised real interest rates, sparked inflation, and undermined faith in the currency.

<sup>3</sup> Real annual GDP slowed from 7.1% in 1999 to 3.9% in 2000.

<sup>4</sup> Global Insight projects that the overall economic effects of the Tsunami that hit India and several other countries in December 2004, will be relatively minor. See Global Insight, *India: Current Situation: Highlights*, January 17, 2005.

United States, China, and Japan).<sup>5</sup> However, its per capita GDP on a PPP basis (a common international measurement of a nation's living standards) was \$2,780, equal to only 7.4% of U.S. levels. Poverty is perhaps India's greatest problem. According to the World Bank, India has 433 million people (44.2% of the population) living below the international poverty measurement of less than \$1 per day.<sup>6</sup>

India's trade is relatively small. According to the World Trade Organization (WTO), India was the world's 31<sup>st</sup>-largest merchandise exporter, and the 25<sup>th</sup>-largest importer, in 2003.<sup>7</sup> Merchandise exports and imports totaled \$63 billion and \$77 billion, respectively. India's principal exports were pearls and precious and semi-precious stones (14.8% of total), textiles (10.8%), and clothing (10.5%). Its top three imports were petroleum (27.0% of total), pearls and precious and semi-precious stones (9.6%), and gold and silver (8.3%).<sup>8</sup> India's major export markets were the United States (18.1% of total), the United Arab Emirates, and Hong Kong, and its top sources for imports were the United States (6.5% of total), China, and Belgium.

## **India's IT Sector**

The Indian government has made the development of India's Information Technology (IT) a top priority. Over the past few years, IT has been one of India's fastest-growing economic sectors and a major source of service exports.<sup>9</sup> For example, software and service exports in 2003 totaled \$12.5 billion, 30% higher than the previous year. The Indian government's Information Technology Action Plan seeks to boost software and service exports to \$50 billion by 2008 and to increase the contribution of IT to India's GDP from the current level of 2% to 7.7%. Currently, more than 60% of India's software and service exports go to North America, mainly to the United States.<sup>10</sup>

## **Comparisons Between India and China**

Many analysts argue that India's economy has failed to live up to its potential, especially relative to other developing countries, such as China, which has a comparable population size but has enjoyed far greater economic development in recent years. In 1990, India's economy (GDP on PPP basis) was about three-quarters the size of China's, but by 2003 it had fallen to 44% of China's size. India's living standards (per capita GDP on PPP basis) were slightly greater than China's in 1990, but by 2003 they had fallen to about half of China's. India made small gains in FDI flows relative to China from 1990 to 2003 (rising from 2% to 7%); however, the total level of FDI stock in China remains substantially higher than in India. In fact, FDI flows to China in 2003 alone (nearly \$54 billion) were 54% higher the cumulative stock of FDI in India through 2003

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<sup>5</sup> PPP data reflects foreign data in national currencies converted into U.S. dollars, based on a comparable level of purchasing power these data would have in the United States.

<sup>6</sup> The World Bank notes that India has made significant progress in reducing poverty, especially in recent years. It estimates that India's poverty rate in the 1970s was over 50%. Official Indian government poverty rate measurements differ from World Bank data; it estimates that the poverty rate at 26% (at the end of the 1990s), down from 36% in 1993/1994.

<sup>7</sup> In terms of trade in commercial services, India was the 21<sup>st</sup>-largest exporter (\$25 billion), and the 21<sup>st</sup>-largest importer (\$22 billion) in 2003.

<sup>8</sup> Much of India's trade consists of diamonds. India imports rough diamonds, which are cut and polished, then re-exported.

<sup>9</sup> According to the Indian government, India's IT sector has grown at an average annual compound rate of over 50% since 1991.

<sup>10</sup> Global Insight: India Interim Forecast Analysis: Trade and External Accounts, January 17, 2005.

(about \$35 billion). Many economists attribute the sharp widening economic gaps between India and China to differences in the pace and scope of economic and trade reforms undertaken by each country, where China has substantially reformed its trade and investment regimes (which has contributed to sharp rises in GDP growth, trade, and FDI flows), India's economic reforms have been far less comprehensive and effective. For example, China's average tariff has fallen from 43% in 1992 to 12% in 2002. India's average tariff during this period dropped substantially, from 128% to 32%, but still remains among the highest in the world.

## U.S.–Indian Economic Relations

Trade between the United States and India is relatively small, but has risen sharply over the past few years. In 2004, U.S. merchandise exports to and imports from India are estimated to have totaled \$6.1 billion and \$15.5 billion, respectively (see **Table 1**), making India the 24<sup>th</sup> largest U.S. export market and the 18<sup>th</sup> largest supplier of U.S. imports.<sup>11</sup> In 2004, U.S. merchandise exports to India rose by 22.6%, while imports rose by 18.4%, over 2003 levels. Major U.S. exports to India included electrical machinery, chemicals, unfinished diamonds. Top U.S. imports from India were non-metallic manufactured minerals (mainly processed diamonds), clothing and apparel, and miscellaneous manufactured items (mainly jewelry).

According to Indian government data, the United States is India's second largest source of FDI with cumulative FDI at \$4.1 billion or 10.6% of total FDI in India. Major sectors for U.S. FDI include energy, telecommunications, and electrical equipment.

**Table 1. U.S.–India Merchandise Trade: 2001–2004**

(\$ millions)\*

	2001	2002	2003	2004	2003/2004 % change
<b>Total U.S. Exports</b>	<b>3,764</b>	<b>4,098</b>	<b>4,986</b>	<b>6,113</b>	<b>22.6</b>
Electrical machinery, apparatus, Appliances, and parts	311	306	344	475	38.2
Organic Chemicals	174	227	267	482	80.4
Non-metallic mineral manufactures (mainly raw diamonds)	162	218	297	450	51.5
<b>Total U.S. Imports</b>	<b>9,738</b>	<b>11,818</b>	<b>13,053</b>	<b>15,455</b>	<b>18.4</b>
Nonmetallic mineral manufactures (mainly finished diamonds)	2,180	2,931	2,962	3,309	11.7
Articles of apparel and clothing	1,934	2,064	2,156	2,378	10.3
Miscellaneous manufactured products	752	1,073	1,424	1,767	24.1

\*Data for 2004 estimated based on actual data for January–November 2004.

**Source:** U.S. International Trade Commission DataWeb.

<sup>11</sup> U.S. exports and imports of services to and from India were \$3.7 billion and \$2.2 billion, respectively.

## Major U.S.–Indo Trade Issues

India's sizable population and large and growing middle class make it a potentially large market for U.S. goods and services.<sup>12</sup> However, a number of factors hamper increased economic ties. First, in addition to maintaining high tariff rates on imports (especially on products that compete with domestic products), India also assesses high surcharges and taxes on a variety of imports. Major non-tariff barriers include sanitary and phytosanitary restrictions, import licenses, regulations that mandate that only public sector entities can import certain products, discriminatory government procurement practices, and the use of export subsidies.<sup>13</sup> A variety of restrictions are placed on foreign services providers and on the level of permitted FDI in certain industries. Second, India continues to maintain a number of inefficient structural policies which affects its trade, including price controls for many "essential" commodities, extensive government regulation over many sectors of the economy, and extensive public ownership of businesses, many of which are poorly run. Third, despite India's attempt to develop internationally competitive IT industries (such as software), U.S. government officials charge that India has a poor record in protecting intellectual property rights (IPR), especially for patents and copyrights. The International Intellectual Property Alliance estimated U.S. losses of \$420 million due to trade piracy in 2003—nearly three-quarters of this in the categories of business and entertainment software—and noted "very little progress in combating piracy."

India's extensive array of trade and investment barriers has been criticized by U.S. government officials and business leaders as an impediment to its own economic development, as well as to stronger U.S.–Indian ties.<sup>14</sup> For example, in September 2004, Alan Larson, U.S. Under Secretary of State for Economic, Business, and Agricultural Affairs, stated that "trade and investment flows between the U.S. and India are far below where they should and can be," adding that American exports to India "have not fared as well" as have Indian exports to the United States and that "the picture for U.S. investment is also lackluster." He identified the primary reason for the suboptimal situation as "the slow pace of economic reform in India."

Some U.S. interest groups have expressed concern that closer U.S.–India economic ties could accelerate the practice by some U.S. firms of outsourcing IT and customer service jobs to India.<sup>15</sup> Various proposals have been made in Congress and various State governments to restrict outsourcing work overseas. Bush Administration officials have expressed opposition to government restrictions on outsourcing, but have told Indian officials that the best way to counter such "protectionist" pressures in the United States is to further liberalize its markets. Other U.S. interest groups have raised concern over the outsourcing of financial services (such as call

<sup>12</sup> Estimates of the size of India's middle class widely differ. Using Indian standards, estimates of the middle class run as high as 300 million people. The Commerce Department estimates that India has 20 million "well-off consumers" with annual incomes exceeding \$13,000, and 80 million people with incomes over \$3,500, and 100 million people with incomes over \$2,800.

<sup>13</sup> Historically, India maintained extensive non-tariff barriers on many imports, based on balance-of-payments reasons. However, in 1999, a WTO dispute resolution panel ruled that these restrictions were no longer justifiable, which prompted India (in 2001) to remove many of its quantitative import restrictions (although many of these barriers were replaced with high tariffs).

<sup>14</sup> In recent years, India and the United States have pursued a number of initiatives to improve commercial ties: In March 2000, a framework for bilateral economic cooperation was created through several working groups as a new U.S.–India Economic Dialogue; July 2003 saw the inaugural session of the U.S.–India High-Technology Cooperation Group; and, in January 2004, the "trinity" issues of dual-use high-technology trade, and civilian nuclear and civilian space cooperation became subsumed under the Next Steps in Strategic Partnership (NSSP) initiative.

<sup>15</sup> The 108<sup>th</sup> Congress passed H.R. 2673 (P.L. 108-199), which limits certain federal government contractors from outsourcing work overseas.

centers) to other countries that entail transmitting private information of U.S. consumers.<sup>16</sup> U.S. officials have urged India to enact new privacy and cybersecurity laws to address U.S. concerns over identity theft.<sup>17</sup>

## Prospects for India's Further Economic Reform

India faces a number of significant challenges to its goals of sustaining healthy economic growth and further reducing poverty. Many economists argue that India needs to substantially liberalize its trade and investment regimes, accelerate privatization of state firms, cut red tape and crack down on corruption, and substantially boost spending on its physical and human infrastructure.<sup>18</sup> However, large and continuing government deficits, and the high level of public debt (equal to 62% of GDP in 2003) severely hamper the ability of the government to boost spending for needed infrastructure projects, without major reforms to the tax system and significant cuts in government subsidies. In October 2004, the World Bank country director for India lauded the country's economic achievements, but called accelerating reforms "essential" for sustained growth and poverty reduction there, and a top International Monetary Fund official said that "India remains a relatively closed economy" and urged greater trade liberalization and regional economic integration.<sup>19</sup>

Organized resistance to desired reforms has come from Hindu nationalist groups that were influential under the BJP government from 1998 to 2004. As a "sister organization" to the Rashtriya Swayamsevak Sangh (RSS)—a leading Hindu nationalist organization—the Swadeshi Jagaran Manch (SJM) has taken the lead in efforts to forward the *swadeshi* (or self reliance) cause. According to the SJM, "The Western notion of a global market does not fit into the *swadeshi* approach," nor does the "Western notion of individual freedom, which fragments and compartmentalizes family, economy, culture, and social values ...." Such anti-globalization policies continue to enjoy limited, but still substantial backing among Indians. Moreover, the surprise May 2004 election upset defeat of the BJP seated a new national coalition led by the Congress Party that is supported by a group of communist parties. Early alarm was sounded that the influence of communists in New Delhi might derail India's economic reform efforts; however, Indian industrial leaders have sought to assure foreign investors that Left Front members are not "Cuba-style communists," but can be expected to support the UPA reform agenda. The communist Chief Minister of West Bengal has himself actively sought corporate investment in his state.<sup>20</sup>

Despite the sometimes considerable resistance to further progress with India's economic reforms, most analysts believe that the Congress-led coalition will not alter New Delhi's policy direction in any meaningful way. Prime Minister and Oxford-educated economist Manmohan Singh served as finance minister from 1991–1996 and has been the architect of major Indian economic reform and

<sup>16</sup> See CRS Report RS21809, *Financial Services Industry Outsourcing and Enforcement of Privacy Laws*, by M. Maureen Murphy and Angie A. Welborn.

<sup>17</sup> In 2001, the U.S.–India Cyberterrorism Initiative was established to discuss a number of cybersecurity issues. The latest meeting was held in October 2004.

<sup>18</sup> On the political front, tensions with Pakistan and continued violence in the disputed territory of Kashmir pose serious threats to India's long-term economic health.

<sup>19</sup> Remarks by Michael Carter, India Director, World Bank Group, October 19, 2004; and David Burton, Director, Asia and Pacific Department, International Monetary Fund, October 21, 2004.

<sup>20</sup> See the Swadeshi Jagaran Manch at <http://www.swadeshi.org>; Edward Luce, "Communists Set to Back Delhi's Reformist Budget," *Financial Times* (London), June 17, 2004; "India Inc Homes in on Red Citadel," *Indian Express* (Delhi), May 21, 2004.

liberalization efforts. The new government’s first budget, released in July 2004, generally was lauded by Indian industrial groups as “progressive and forward-looking.”<sup>21</sup> Still, New Delhi’s movement on key reform issues could remain slow in the near- and medium-term.

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<sup>21</sup>Joanna Slater, “Reformers Take Control,” *Far Eastern Economic Review* (Hong Kong), June 3, 2004; “CII Applauds UPA’s Maiden Budget,” Confederation of Indian Industry Press Release, New Delhi, July 8, 2004.